

SECTION XII--INTERPRETATIONS

ACCOUNTING INTERPRETATION NO. 1

Subject: Encumbering

This interpretation is to clarify those items that may or may not be encumbered at the school's fiscal year-end.

SDCL 13-11-8 states:

The school board may by resolution at its first meeting in July encumber that portion of the unexpended budget from the prior fiscal year for which legal obligations were incurred but were not paid. The resolution shall state the budget account and amount encumbered. The business manager shall keep a detailed listing by payee and amount supporting such amount shown in the resolution.

The following "encumbrance" definition comes from the "School Accounting Manual":

Purchase orders, contracts and salary or other commitments which are chargeable to an appropriation and for which a part of the appropriation is reserved. They cease to be encumbrances when paid or actual liability is set up.

In accordance with SDCL 13-11-8 and the encumbrance definition the only items that can be encumbered are outstanding purchase orders for which a legal obligation exists, contracts and/or other legal obligations (provided a detailed listing is maintained) for which service has not been received either in part or in full as of the close of the fiscal year. At the time of receiving the contracted service or a fulfilled purchase order they then become payables and, thus cease to be encumbrances.

The entries to record encumbrances at the end of the fiscal year are as follows:

Encumbrances	xx	
Reserve for Encumbrances		xx

The Encumbrance account balance is then closed out to Fund Balance, along with Expenditures, at the end of the fiscal year, as follows:

Fund Balance	xx	
Encumbrances		xx
Expenditures		xx

The Reserve for Encumbrances account is not closed out; it is this account which is charged, by means of a separate Expenditures account (Prior Year Expenditures), with the actual expenditures when they occur.

When goods or services are received in the subsequent fiscal year (e.g., FY2002) which were encumbered in the previous fiscal year (FY2001), the entry to record the expenditure is:

SECTION XII--INTERPRETATIONS

Prior Year (FY2001) Expenditures	xx	
Cash		xx

The specially designated Prior Year Expenditures account is used to differentiate this particular expenditure from the current year's expenditures.

After all orders encumbered in the previous year have been received and recorded, the Prior Year Expenditures account is closed out against the Reserve for Encumbrances account as follows:

Reserve for Encumbrances	xx	
Prior Year Expenditures		xx

If the actual cost of the goods or services encumbered exceeds the amount encumbered, the excess amount is debited to Fund Balance. If the actual cost is less than the amount encumbered, the difference is credited to Fund Balance.

An alternative to encumbering is to include the items not yet received into the next year's budget before final adoption. If the goods intended for the subsequent year are received prior to the start of the new year, the goods should be treated as inventory of supplies rather than expenditures. After the start of the new fiscal year, a credit should be made to inventory and debit entries should be made in the general journal to the appropriate expenditure categories. Remember that the journal entries to record the expenditures should also be posted in the expenditure budget record to the proper budget categories. (See Accounting Interpretation No. 14)